

INTERPRETATIONS

§ 250.120 Underwriting bonds payable from proceeds of State sales taxes.

(a) The opinion of the Board of Governors of the Federal Reserve System has been requested with respect to the authority of member State banks to underwrite securities issued by States and political subdivisions thereof, with particular reference to \$35,750,000 of Public Building Bonds, 1961, Series D, and Public School Plant Facilities Bonds, 1961, Series C, of the State of Washington. The Comptroller of the Currency has held that said bonds are eligible for underwriting by national banks.

(b) Paragraph Seventh of section 5136 of the Revised Statutes (12 U.S.C. 24) provides that a national bank "shall not underwrite any issue of securities", but further provides that this restriction "shall not apply to * * * general obligations of any State or of any political subdivision thereof". The 20th paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 335) subjects State member banks to the same limitations with respect to the underwriting of investment securities "as are applicable in the case of national banks under paragraph 'Seventh' of section 5136."

(c) Under the statutory provisions quoted above, member banks are prohibited from underwriting securities issued by a State unless those securities are "general obligations". In the opinion of the Board of Governors, securities are not "general obligations" unless they are backed by the full faith and credit of the issuer. As stated in paragraph 520 of the "Digest of Opinions of the Office of the Comptroller of the Currency", "Securities payable only out of particular funds or out of the obligor's revenues from a particular source are not general obligations." In order to be eligible for underwriting by member banks, the issuer must possess the power of general property taxation and the securities must be supported by that power, as a part of the "full faith and credit" of the issuer.

(d) The bonds in question are issued pursuant to Washington Laws of 1961, Ex Sess., Chapters 3 and 23. These statutes provide that the bonds "shall not

be a general obligation of the state of Washington but shall be payable * * * from the proceeds of retail sales taxes * * *." The statutes also provide that "the state undertakes to continue to levy the taxes referred to herein and to fix and maintain said taxes in such amounts as will provide sufficient funds to pay said bonds and interest thereon until all such obligations have been paid in full."

(e) The statutory provisions that the bonds in question "shall not be a general obligation of the State of Washington" and "shall be payable * * * from the proceeds of retail sales taxes" appear to indicate that the bonds will not be supported by the full faith and credit of the State, including its power of general property taxation. If this is correct it follows on the principles previously stated, that these bonds would not be "general obligations" of the State within the meaning of R.S. 5136 and would not be eligible to be underwritten by member banks. The undertaking to levy retail sales taxes that will provide sufficient funds to pay the bonds in full reflects the intent of the State that the bonds (and interest thereon) shall be paid, but it does not negate the plain statement in the Washington statute that the bonds shall be payable from a particular source—namely, the proceeds of retail sales taxes—and are not general obligations.

(f) This conclusion does not conflict with the decision of the Supreme Court of Washington in *State of Washington v. Martin*, decided August 7, 1963. It was there held that bonds of this nature are "issued upon the credit of the state and are in truth debts of the state." However, the Court made it quite clear that such bonds are not supported by the full faith and credit of the State and its plenary taxing power. Under the State constitutional and statutory provisions dealt with in that decision, bonds of the State of Washington that are payable from a particular source of revenue constitute a debt of that State but are not general obligations thereof.

(g) For these reasons, the Board concludes that the bonds in question are not "general obligations" within the purview of section 5136 of the Revised

Statutes and consequently are not eligible for underwriting by State banks that are members of the Federal Reserve System.

(12 U.S.C. 24, 335)

§ 250.121 Application of investment securities regulation to member State banks.

(a) *General.* A revision of the Investment Securities Regulation (Part 1 of this title) was issued recently by the Comptroller of the Currency. Under section 9 of the Federal Reserve Act (12 U.S.C. 335) the regulation is applicable to member State banks as well as to national banks, insofar as it conforms to paragraph Seventh of section 5136 of the Revised Statutes (R.S. 5136; 12 U.S.C. 24).

(b) *Provisions of regulation with respect to "exempt securities".* (1) Paragraph Seventh refers to two areas of securities transactions by a bank: (i) Underwriting and dealing, which are grouped as "underwriting" herein, and (ii) investing (called "purchasing for its own account" in the statute).

(2) The statute contains a general prohibition against a member bank (i) underwriting securities or (ii) investing more than 10 percent of its capital and surplus in the securities of any one obligor. In addition to this 10 percent limitation, the power of national banks and member State banks to purchase securities for investment is subject to "such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe". The term *investment securities* is defined in paragraph Seventh and is subject to "such further definition * * * as may by regulation be prescribed by the Comptroller".

(3) The statute also provides, however, that "The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for [the bank's] own account, investment securities shall not apply to obligations of the United States or general obligations of any State or of any political subdivision thereof," or certain other securities. In other words, national banks and member State banks are legally free (i) to underwrite such "exempt securities" and (ii) to invest therein without regard to the 10 per-

cent limitation mentioned in this section.

(4) The authority of the Comptroller of the Currency to issue investment regulations pursuant to R.S. 5136 does not include authority to exempt additional kinds of securities from the prohibition against underwriting or the prohibition against investing more than 10 percent of capital and surplus in securities of any one obligor. Despite this, §1.3 of this title, the Comptroller's recent revision of the Investment Securities Regulation, contains a definition of *public security* and §1.4 of this title states that "A bank may deal in, underwrite, purchase and sell for its own account a public security subject only to the exercise of prudent banking judgment." The term *public security* is so defined that, in effect, the regulation purports to authorize national banks and member State banks to underwrite, and to purchase without limitation on amount, securities that are not exempted by law from the statutory prohibition against underwriting and against investing in excess of the 10 percent limitation. For example, the terms of the regulation would authorize such banks to underwrite some securities of public corporations that are payable solely out of revenues derived from the operation of a tunnel, turnpike, bridge, or the like, despite the fact that the applicable statute does not exempt such securities from the general prohibition against underwriting by banks.

(5) Since the Comptroller is not authorized by law to expand the category of exempt securities established and described in paragraph Seventh of R.S. 5136, the current regulation does not have the force and effect of law insofar as it attempts to do this. Accordingly, member State banks are informed that, in the opinion of the Board of Governors, the only securities that are exempt from the limitations and restrictions of paragraph Seventh are those specified in R.S. 5136. Unless a particular issue of securities is exempt by virtue of that provision of law, member State banks may not underwrite the issue, and the 10 percent limit is applicable to investments therein. Since so-called *revenue obligations* of the kinds